AGENDA DATE: 8/16/00
AGENDA ITEM: 11C

STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

IN THE MATTER OF THE PETITION OF NEW JERSEY-AMERICAN WATER COMPANY, INC. FOR APPROVAL OF A FINANCIAL SERVICES AGREEMENT	))))	ORDER OF APPROVAL BPU DOCKET NO.: WF00040252

Cozen and O'Connor, by William D. Lavery, Jr., Esq., Cherry Hill, N. J. 08002, for New Jersey-American Water Company, Inc.

Fred S. Grygiel, Chief Economist, Mark C. Beyer, Manager, and Mario Aguilar, Accountant II, Office of the Economist on behalf of the Staff of the Board of Public Utilities

BY THE BOARD:

On April 27, 2000 New Jersey-American Water Company, Inc. ("Petitioner" or "NJAWC"), a public utility corporation of the State of New Jersey, having a principal office at 500 Grove Street, Haddon Heights, New Jersey 08035, filed a Petition with the New Jersey Board of Public Utilities ("Board"), pursuant to N.J.S.A. 48:3-7.1 and 3-7.2 requesting approval to enter into a Financial Services Agreement ("Agreement") with American Water Works Financing Corporation.[1] The Petition states that both NJAWC and AWCC are wholly-owned subsidiaries of American Water Works Company, Inc. ("AWW"). In addition to NJAWC, AWW wholly owns 24 utility subsidiary companies which serve more than 10 million people in over 1,000 communities in 23 states.

Under the Agreement, AWCC will provide two types of financial services. First, AWCC will provide NJAWC with access to short-term and long-term debt. Second, AWCC will provide NJAWC cash management through cash sweeps and investment of excess cash. NJAWC seeks permission to enter into the Agreement and believes that the financial services arrangement accomplished via the Agreement is reasonable and in the public interest.

[1] Subsequent to the filing of the Petition, Petitioner advised the Board and the parties that the name of the financing corporation had been revised to American Water Capital Corp. ("AWCC").

A. ACCESS TO SHORT AND LONG-TERM DEBT

At present, NJAWC provides for its own financing needs, whether those needs be via lines of credit or long-term debt. Generally speaking, NJAWC obtains short-term debt (i.e., debt with a maturity of one-year or less) from banks and issues long-term debt through competitive bids in the public market as well as through tax exempt financings.

Because of changes in the financial markets, an opportunity exists for NJAWC and its affiliates to borrow on an unsecured basis at rates prevailing in the public market while minimizing borrowing expenses.[2] Lenders have been syndicating and securitizing their loans in larger amounts so they can lend larger amounts and reduce their exposure to a single borrower. Larger loans are less costly for each dollar borrowed because up front issuance costs remain relatively constant regardless of the size of the loan. Additionally, changes in the federal securities laws have enabled public security markets to become attractive alternatives to private placements and bank borrowings on which utilities have traditionally relied. The natural result is that borrowers obtain faster and easier access to the public debt market that has in turn encouraged those markets to provide short-term debt opportunities on attractive terms.

These developments in the financial markets have caused lenders, such as insurance companies, to favor public markets as more attractive investment alternatives than the traditional, secured, privately placed bonds that were, at one time, the mainstay of their portfolios. As institutional lenders such as insurance companies moved into the public market, the dollar volume of the issues that the market was willing and able to accommodate also increased. As the cost per dollar of substantial borrowings decreased and competition among lenders in the market increased, it has become apparent that borrowers can derive significant savings if they can participate in that market. Clearly, however, borrowers can derive those benefits only if the amounts they borrow are large enough, and their credit rating high enough, to meet the market's significant entry-level requirements.

The natural result of these changes in the financial markets has enabled companies to consolidate the cash management, short-term borrowing and funds investment functions for operating subsidiaries in a single financing subsidiary. Through pooling of borrowing requirements on both short-term and long-term bases, NJAWC and its affiliates can borrow large enough amounts that will enable them to obtain advantageous terms that are presently available. Combined borrowing power increases the efficiencies of borrowing operations and lowers the cost thereof.

In accordance with the provisions of the Agreement, AWCC will permit NJAWC to "pool" its borrowing requirements with AWW (collectively the "Participants"), each of which will enter into a separate agreement with AWCC, with terms substantially similar to those in the Agreement. As a result, the Agreement will enable NJAWC to: (i) reduce the amount of administrative costs it incurs (per dollar of debt issued), in connection with debt issuances through the spreading of administrative costs over a larger issuance amount; and (ii) reduce overall borrowing costs. Such reduced costs will be reflected when rates are set.

[2] Under the terms of the Agreement, AWCC will not be precluded from engaging in secured borrowings if those borrowings provide the most favorable terms available.

Under the respective agreements with AWCC, each Participant (including NJAWC) will, each year, provide AWCC with an estimate of its borrowing requirements for the coming year and, on a rolling basis, for one to three years in advance. On the basis of this information, AWCC will arrange to obtain funds necessary to meet the Participants' short and long-term debt requirements. AWCC will arrange for short-term borrowings (i.e., borrowings with maturities of one year or less) through bank lines of credit and, where appropriate, through short-term obligations issued in the public market. To meet the participants' requirements for long-term debt, AWCC will register its own debt securities for sale in the public market by filing a "shelf registration" with the United States Securities and Exchange Commission. A "shelf registration" involves the registration of a maximum amount of debt to be issued and puts that amount "on the shelf" from which it can be drawn down and sold from time to time in increments. Use of shelf registrations will enable AWCC to respond quickly to changes in the public market and to sell securities when rates and terms are most favorable.

AWCC will loan the proceeds of its borrowings and debt issuances to Participants, including NJAWC, on the same terms (including maturity and interest rates) as those obtained by AWCC. The indebtedness of NJAWC to AWCC will be evidenced by a note in one of the two forms attached as exhibits to the Agreement. The form of short-term note in the amount of the maximum anticipated short-term borrowings over the course of a year will evidence NJAWC's obligation in respect to short term indebtedness. The form of medium/long-term notes attached to the Agreement will evidence medium and long-term borrowings, which have a specific maturity, amount and payment schedule. Each Participant's debt to AWCC will be unsecured.

AWW will issue a "support letter" for the benefit of the purchasers of AWCC's debt. A "support letter" requires the parent company of a group to continue to own all the issued and outstanding stock of its financing subsidiary, to cause its financing subsidiary to maintain a positive tangible net worth and, if its financing subsidiary is unable to satisfy its obligations when due, to provide funds to assure such payment. AWW's undertaking under its support letter will constitute a separate, registerable security under the Federal Securities laws. As co-registrants, AWW and AWCC will be subject to the statutory liabilities imposed by the Securities Act of 1933 and, AWCC will become a reporting company under the Securities Exchange Act of 1934.

As discussed above, by "pooling" the borrowing requirements of the Participants, AWCC will be able to arrange for the issuance of short and long-term debt on more favorable terms and at lower cost than the terms and costs which would normally be applicable to debt issued by NJAWC directly on its own behalf. The projected interest rate that would currently be applicable for short-term loans from AWCC to NJAWC under the Agreement is based upon a spread ("Basis Points" or "BPS") over the 30-day London Interbank Borrowing Rate ("LIBOR"), which is approximately 6.7%. The projected spread under the Agreement is 10-15 BPS, which yields an estimated interest rate of 6.8% to 6.85%. This interest rate is lower than the most favorable interest rate currently available to NJAWC for short-term borrowing from banks. The projected interest rate that would currently be applicable for long-term loans from AWCC to NJAWC under the Agreement would depend on the duration of the loan. In general, however, the interest rate would be approximately 170 BPS over the rate for U.S. Treasury Securities. For example, the current interest rate for the 10-year U.S. Treasury Security is 6.1%. Thus, the current long-term interest rates under the Agreement would be 7.8%. Nothing in the Agreement, however, prevents NJAWC from borrowing from others or obtaining cash management services from others on whatever terms it deem appropriate. Accordingly, NJAWC can take advantage of tax-exempt financings, to the extent the same are available to it.

Through this Petition, NJAWC is requesting approval only to enter into the Agreement and to obtain future funding through AWCC in accordance with the terms of the Agreement. NJAWC is not requesting herein approval for any specific debt issuance for which approval is required under existing statues and regulations. NJAWC understands that it must timely file for such financing approval in accordance with the provisions of N.J.S.A. 48:3-9 as is normally required. It is contemplated that NJAWC's application for such long-term debt will seek approval to issue debt not to exceed a specified amount within a set time period and within specific terms and parameters. Approval of the Agreement will permit NJAWC to issue to AWCC short-term debt instruments (i.e., debt with a maturity of twelve months or less), for which approval is not otherwise required under governing statutes or regulations.

B. CASH MANAGEMENT SERVICES

AWCC will provide cash management services which will enable NJAWC and other Participants to manage their cash balances more efficiently. Under this program, operating cash surpluses of each Participant (including NJAWC) will be "swept" on a daily basis. NJAWC will be allowed to determine the amount of operating cash surpluses to be swept. Such cash surplus shall be treated as a "loan" to AWCC, and AWCC will pay the Participant interest on that loan at the same rate that AWCC is required to pay for its own short-term borrowings under AWCC's bank lines. The projected interest rate that would currently be available to the cash surplus of NJAWC that is treated as a "loan" to AWCC under the Agreement is from 6.8% to 6.85%. This interest rate exceeds the interest on excess cash balances that NJAWC would otherwise be able to receive on bank deposits and other available short-term investment options.

The cash that AWCC obtains through the daily cash sweeps will be used to offset the amount that AWCC would otherwise be required to obtain under bank lines of credit and/or through the public market on a short-term basis. The excess cash will be used by AWCC to make loans to those Participants with short-term cash requirements, for which they will also pay AWCC interest at the same rate as AWCC pays for its own short-term borrowings. The projected interest rate under the Agreement that would currently be applicable for short-term loans to NJAWC of excess cash that AWCC has obtained through daily cash sweeps is 6.8% to 6.85%. By using system-wide internally generated cash obtained through the daily cash sweeps, AWCC will be able to reduce the overall principal amount of short-term borrowings from external sources, thereby reducing borrowing costs, such as commitment fees. This reduction in costs will benefit all Participants, including NJAWC.

Since the Agreement contemplates that NJAWC, a wholly-owned subsidiary of AWW, will be loaning money to AWCC, also a wholly-owned subsidiary of AWW, N.J.S.A. 48:3-7.2 requires approval of the Board in writing of such cash management service.

C. CHARGES TO NJAWC UNDER THE AGREEMENT

Petitioner states that the costs incurred by AWCC in connection with its bank credit lines and short-term public borrowings will be divided among NJAWC and the other Participants in proportion to the maximum principal amount that each Participant requests be made available to it during the course of a given year. The costs incurred by AWCC in connection with each long-term debt issuance by AWCC will be passed through to NJAWC and each Participant in proportion to the principal amount of that issuance that is loaned to each Participant. Additionally, AWCC also will charge NJAWC and each Participant a portion of AWCC's overhead. These overhead costs will be allocated among NJAWC and the other Participants in the same proportion as each Participant's long and maximum-short term debt borrowings and investments in a year bear to the total of all of the long and maximum short-term borrowings and investments by all of the Participants together during the course of the same year. It is expected that overhead charges will be more than offset by the reduction in the costs incurred by the NJAWC and the other Participants to obtain their own financing. No profit element will be included in any charges rendered by AWCC to NJAWC.

D OTHER TERMS OF THE AGREEMENT

The Agreement provides that the obligations of NJAWC and the other Participants in the financing program are several and not joint. Accordingly, NJAWC's obligations will be limited to the amount that it actually borrows. Additionally, NJAWC has the right to inspect AWCC's books and records. NJAWC may terminate the Agreement by giving 10 days prior written notice. AWCC can terminate the Agreement by giving 90 days prior written notice. No termination will effect any amounts then outstanding or due under an outstanding or due under an outstanding note.

The Board, after considering the verified Petition, the exhibits submitted therewith and the discovery responses of Petitioner, being satisfied that the Agreement is to be made in accordance with law and is not contrary to the public interest, HEREBY APPROVES said Agreement for services to be provided to New Jersey-American Water Company, Inc. by American Water Capital Corp.

This Order is issued subject to the following provisions:

1. Petitioner may not consummate any long-term financing without returning to the Board via Petition seeking such authorization;

2. Petitioner may not borrow any sum from AWCC for a period of time greater than one year without approval of the Board;

3. Petitioner may only deposit with AWCC such surplus cash as it would otherwise have available for investment in short-term investment instruments;

4. Petitioner shall make available to the Board or the Board's Staff, upon request, such information and records deemed relevant by the Board and which pertain to the services provided by AWCC and the amounts paid for those services;

5. The Board retains the right to review the reasonableness of the actual charges in the context of any subsequent rate case proceeding.

6. This Order shall not affect or in any way limit the exercise of the authority of this Board or of the State, in any future Petition with respect to rates, franchises, services, financing, accounting, capitalization, depreciation or any other matters affecting the Petitioner.

DATED: August 17, 2000

BOARD OF PUBLIC UTILITIES
BY:

[SIGNED]
HERBERT H. TATE
PRESIDENT

[SIGNED]
CARMEN J. ARMENTI
COMMISSIONER

[SIGNED]
FREDERICK F. BUTLER
COMMISSIONER

ATTEST: [SIGNED]
FRANCES L. SMITH
SECRETARY

/rb